NSDL
Technology, Trust & Reach

The Financial Kaleidoscope

Defining the different shapes of investment

January 2017

From The Editor's Desk

Dear Reader,

As you may be aware, India resorted to demonetization of its ₹500 & ₹1,000 currency notes on November 8, 2016. The currency notes of Rupees Five Hundred and Rupees One Thousand were withdrawn from circulation and were no longer considered to be legal tender from 9th November 2016. Historically, many countries attempted demonetization when they faced difficult economic cycles and invariably, the results often proved detrimental. In India however, the move was introduced in a well-run economy with the objective of attaining transparency, a reduction in the volume of black money, eliminating corruption, and terror funding.

There have been varied opinions pertaining to the aftermaths of demonetization in India. While some believe that demonetization would immensely help in removing tax evasion, increasing flow of financial savings, formalizing the economy, increasing Gross Domestic Product (GDP) and consequently resulting in an inclusive society; while others believe that the GDP numbers and overall growth of the economy would be hampered to a great extent and would push the economy backward.

This issue of Kaleidoscope particularly discusses the impact that demonetization has had so far on the economy and in particular the securities market. The resulting influence thus has opened up different investment avenues for investors to invest in the Capital Markets in India. This issue also discusses how & why investors should look at Equity & Mutual Funds as important avenues of investing.

Best Regards,
NSDL

Click & Find: Investment Avenues to beat Inflation

Demonetization has caused banks to receive an enormous amount of liquidity in cash deposits by customers. This could potentially bring down the cost of funds for banks and consequently, also bring down their Interest rates on investments such as Recurring Deposits (RDs), Fixed Deposits (FDs) etc.

Several PSU and Private Sector banks have already started reducing interest rates for bulk deposits. This fall in interest rates ranges between 125 basis points and 190 basis points for various tenures. Thus, investment in FDs & RDs, though considered as a safe investment, cannot be considered a lucrative investment avenue anymore. To understand this context, we can see the following table which captures Fixed Deposit rates for various tenures announced by banks pre-demonetization and post-demonetization.

Fixed Deposits (FDs) Tenure	Rates pre-demonetization (In %)	Rates post- demonetization (In %)
One year	7	6.75
390 days to 2 years	7.25	7.10
3 years 1 day to 5 years	6.75	6.5

Note: 1) Average Interest rates on FDs have been considered
2) Compiled from various sources

For any investment, considering the time value of money is essential. Although this implies that the present value of money has the potential to increase through interest earned over time, it is important to understand that the impact of inflation causes the value of money to rather decrease over time as well. Thus, when an individual plans his or her investments, they should be aware of the fact that the returns on investments need to beat the rate of devaluation caused by inflation, for effective earnings.

Therefore, with banks slashing the interest rates on deposits, customers have to look out for much better investment avenue which will beat the inflation as well as earn good amount of profits. Some of the investment avenues that can beat the inflation rate & fulfill the needs of the customers by maximizing the returns are in investments such as Mutual Funds, equity market etc. Over the period, investments in Mutual Funds & Equities have provided handsome returns to investors in the long run. Also, investing in the National Pension System (NPS) is yet another viable option available to investors looking at retirement plans, since it is a product that offers investor's park in their funds in different segments of Capital Markets such as equity, corporate debt, bonds, Government Securities etc.

Let's have a detailed look at the various types of Mutual Funds as one of the investment avenues that an investor can consider to invest in our 'Get Started' section.

Get Started : Investing in Mutual Funds

Investment in Mutual Funds

Mutual funds generally buy and sell securities in large volumes which allow investors to benefit from lower trading costs. Investing in Equity Mutual Funds (EMFs) yields good long term returns and has no capital gains tax on long term investments. The mutual fund investment avenue is suited for those people who do not have the time and expertise for identifying and managing the investment in stock markets. Even the smallest investor can get started by investing in mutual funds because of the minimal investment requirements. An investor can start investing in Mutual Funds through Systematic Investment Plan (SIP) mode with a minimum sum of ₹500 per month.

So let's understand what a Mutual Fund is?

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. The corpus of the fund is then deployed in investment alternatives to meet predefined investment objectives of the mutual fund scheme. The income earned through these investments and the capital appreciation realized are shared by its unit holders in proportion to the number of units owned by them. The three advantages of investing in mutual funds are:

- Access to professional fund managers
- Diversification
- Liquidity

Investors having low risk appetite may contemplate investments in debt mutual funds. Schemes that limit investments in debt securities such as Treasury Bills, Government Securities, Bonds and Debentures are called debt funds.

Mutual Fund Investments in context of Demonetization

Historically, debt funds have generated better post-tax returns than Fixed Deposits (FDs). On a relative basis, investments in debt instruments through mutual funds or otherwise can potentially earn better returns than fixed deposits. Demonetization would perhaps bode well for the long duration gilt funds if the interest rates fall. Consequently, the debt funds would gain due to increase in bond prices. In addition to long-term investments in equity and debt, an investor can keep some cash in form of liquid funds or invest in ultra-short term funds to meet the emergency needs.

The different kind of mutual fund debt schemes are discussed below:

Debt Funds

Debt funds are mutual funds that invest in fixed income securities like bonds and treasury bills. Some of the other types of Debt funds are Gilt fund, Monthly Income Plans (MIPs), Short Term Plans (STPs), liquid funds and Fixed Maturity Plans (FMPs). Debt funds can be categorized on the basis of the type of debt securities that the mutual funds invest in. They are:

a) The issuer of the securities - Government, Corporate, PSUs

b) The tenure of the securities - Short term & Long term

The risk and return of the debt funds vary on the basis of tenure and issuer. The different types of debt funds are discussed below:

Issuers of Debt Funds

✓ **Gilt or G-Sec Funds**

Gilt funds invest in treasury bills and government securities. They are preferred by risk averse and conservative investors who wish to invest in the shadow of secure government bonds. These government securities promise lower returns and the maturity period of these securities ranges from medium to long-term. The prices of long-term government securities are very sensitive to interest rate changes; therefore gilt funds are quite susceptible to interest rate movements.

✓ **Corporate Bond Funds**

Corporate bond funds invest in fixed income or debt securities which are issued by the corporates. Corporate Bond Funds are prone to credit risk. Therefore these bonds pay a higher coupon income to compensate for the credit risk associated with them and in turn lure the investors. The corporate bond funds and gilt securities funds can be further divided on the basis of tenure i.e. Short Term and Long Term. These are explained below.

Tenure of Debt Funds

✓ **Short Term Debt Schemes**

The different types of short term debt schemes are:

- **Liquid schemes**

  These are a type of debt schemes that invest only in short term debt securities. They can invest in debt securities of upto 91 days maturity. These schemes are ideal for investors seeking high liquidity with safety of capital.

- **Ultra-short term schemes**

  These schemes invest in money market and other short term securities of maturity ranging between 90 days and 1.5 years. The aim of these funds is to generate a steady return which is obtained through interest income.

  Short term debt schemes invest in securities with small tenures that have low interest rate risk. The tenure of such schemes ranges between 1 year and 3 years and the objective is to deliver steady returns.

✓ **Long Term Debt Schemes**

Long-term debt schemes such as G-sec Funds and Income funds invest in longer-term securities issued by the government and corporates.

Various types of long term debt schemes are discussed below:

- **Diversified debt funds or Income fund**

  Invest in a combination of government debt securities, corporate bonds, debentures and Commercial Paper.

- **Junk bond schemes**

  Invest in securities that have a lower credit rating which is indicative of poor credit quality. Such schemes operate on the premise that the attractive returns offered by the investee companies makes up for the losses arising out of a few defaulting companies.

- **Dynamic debt funds**

  Are flexible in terms of the type of debt securities held and their tenures. They do not focus on long or short term securities and are not restricted to any type of investment or security.

- **Fixed maturity plans**

  Is a debt fund where the duration or the term of the investment portfolio is closely aligned to the maturity of the scheme.

- **Floating rate funds**

  Invest in different debt securities where the interest rate payable by the issuer changes in line with the market.

✓ **Equity Schemes**

The investment objective of a mutual fund whose objective is to seek capital appreciation through investment in growth assets is called equity schemes.

- **Value funds**

  Invest in shares of those companies which have strong fundamentals but might be currently under-valued in the market. These companies are expected to benefit from an increase in price as and when the market recognizes its potential for growth.

- **Growth Funds**

  Invest in those companies whose earnings are expected to grow at a rate higher than the average rate. These funds aim at providing capital appreciation to the investors and usually provide above average returns in bullish markets.

- **Equity Linked Savings Schemes**

  Are diversified equity funds and are required to hold at least 80 percent of its portfolio in equity instruments (in context of India). These schemes offer tax benefits to investors up to an investment limit of ₹1,50,000/- a year. The investment is subject to lock-in for a period of 3 years during which it cannot be redeemed, transferred or pledged.

Blog

Demonetization - Impact of Stock Markets

By Anonymous

On 8th November 2016, PM Narendra Modi announced the cancellation of ₹500 & ₹1,000 notes (demonetization) which resulted in majority of the circulated money being removed from the economy overnight. This was primarily done to curb the black money, make all the counterfeit currency worthless and attack terrorism at its roots.

To understand the impact on the stock market, let's first understand how significant a move this is. In the past many countries have attempted demonetization, some successfully and some unsuccessfully, but all of them were done when their economies were having major problems like hyper-inflation in Germany in the 1920s. This is the first time that a perfectly healthy economy has attempted it and that too to target black money. Because this is a first, there are varied opinions amongst economists on what the impact will be in the future.

The immediate impact of removing so much money from circulation is of course the impact it can have on several sectors that are driven by the black economy like real estate, construction etc., but more so also the sectors that are more driven by cash, because they are the first that are affected when so much money is suddenly removed from circulation.

Further, with large amount of cash formalized into the banking stream, banks empowered by a high amount of current account and savings account (CASA) deposits, have reduced dependence on high cost borrowing. Banks have curtailed deposit rates. High Liquidity in banking system has also resulted in central bank cutting down Interest Rates. Moreover, due to huge deposits growth generated by banks, the borrowing cost for bank has come down and hence most of the Housing Finance Companies have passed on the benefit to consumers who have taken loan from these Institutes by reducing Interest Rates.

Further, post demonetization, due to the increase in cashflow in the banking system & the interest rates of most popular investments in Fixed Deposits & Recurring Deposits further going down, investments in Equity & Mutual Funds is seen as an instrument to generate good tax efficient return in long term beating inflation. As a result, the inflow via SIP route in Mutual Funds has gone up. Mutual Fund SIPs accounts stood at 1.31 crore and the total amount collected through SIP during February 2017 was ₹4,050 crore.

Cash Reserve Ratio (CRR)

In India, banks are required to retain a certain percentage of their deposits as liquid cash. However, banks prefer to deposit this liquid cash with RBI, which is equivalent to having cash in hand. The percentage of the deposits that should be kept aside by banks is called Cash Reserve Ratio. CRR is fixed by RBI. For example: If the bank deposit amount is ₹1,000 and the CRR is 10% per annum, the liquid cash that the bank should have at all times is ₹100. The remaining funds, which is ₹900 in this case can be used for lending and investment purposes. RBI has the power to determine the lending capacity of the banks in India through CRR. They will increase CRR if they want to reduce the amount that the banks can lend and vice versa.

Statutory Liquidity Ratio (SLR)

At the end of every business day, banks are required to maintain a minimum ratio of their Time liabilities (when the bank has to wait to redeem their liabilities) and Net Demand (when bank can withdraw money from these accounts immediately) in the form of liquid assets like gold, cash and government securities. The ratio of time liabilities and liquid assets in demand is called Statutory Liquidity Ratio or SLR. The maximum SLR that The Reserve Bank of India can set is 40% per annum.

Repo Rate

We all approach banks when we face a financial shortfall. Likewise, banks approach The Central Bank, which is The Reserve Bank of India (RBI) in our country if they face financial crisis. Repo Rate or Repurchase Rate is the rate at which the RBI lends funds to commercial banks and other financial institutions within the country. Simply put, banks borrow funds from The Central Bank of India by selling government securities with a legal agreement to repurchase the securities sold on a given date at a predetermined price. The rate of interest charged by RBI while they repurchase the securities is called Repo Rate.

Marginal Standing Facility Rate (MSF)

When banks face acute financial shortage, they can avail this special facility offered by RBI. In MSF, banks can borrow cash from RBI against their approved government securities. This option is preferred during emergency and critical situations only. MSF rate is always higher than Repo Rate as banks need the funds instantly.

Bank Rate

Bank Rate is the rate of interest charged by The Central Bank of India against loans offered to commercial banks. Bank rate is usually higher than repo rate. Unlike repo rate, bank rate directly affects the end user, in this case the customer, as high bank rates mean high lending rates. When bank pay high interest rate to obtain loan from RBI, they in return charge the customer high interest rate to break even. Also known as “Discount Rate”, bank rate is a powerful tool used by the RBI to control liquidity and money supply in the market.

Base Rate

The Reserve Bank of India sets a minimum rate below which banks in India are not allowed to lend to their customers. This minimum rate is called the Base Rate in banking terms. It is the minimum rate of interest banks are permitted to charge their customers.

Marginal Cost of Funds based Lending Rate (MCLR)

RBI made changes to the existing Base Rate system this year. They have introduced Marginal Cost of Funds based Lending Rate or MCLR which is a new methodology to set the lending rates for commercial banks. Previously, banks used to lend as per the Base Rate fixed by RBI but with the introduction of MCLR, banks will have to lend using rates linked to their funding costs. Simply put, bank raises their funds through deposits, bonds and other investments. For the banks to function smoothly, there are costs involved like salaries, rents and other bills. Considering that banks also need to make profits every year, RBI has included the expenses of the bank and have come up with a formula which can be used by banks to determine their lending rate.

Savings Deposit Rate

The interest rate earned by an account holder for the amount maintained in their savings account is called savings deposit rate.

Term Deposit Rate

Customers who deposit money into their account and agrees to fix it till a particular date is awarded with term deposit rate.

“Did You Know”

The oldest stock exchange in the world is Amsterdam Stock Exchange, which was established in 1602 by Dutch East India Company dealing with the printed stocks and bonds. It merged on 22nd September 2000 with the Brussels Stock Exchange and the Paris Stock Exchange to form Euronext, and is now known as Euronext Amsterdam.

“Quote of the month”

In finance textbooks, “risk” is defined as short-term volatility. In the real world, risk is earning low returns, which is often caused by trying to avoid short-term volatility.

Your Questions Our Answers: Mutual Funds

1. **Who all are eligible to invest in schemes of mutual funds?**
   Individual investors above the age of 18, Minors through their guardians, HUFs and Non-Resident Indian (NRI)/Person of Indian Origin (PIO) can invest. Even non-individual investors such as companies, registered societies, trustee of religious and charitable trusts, partnership firms, banks, foreign portfolio investors are eligible to invest in schemes of mutual funds.

2. **What do I have to do to invest in mutual funds?**
   To invest in Mutual Funds, investor has to submit following documents:

   a. KYC (Know Your Customer) documents

   b. Application Form for investment in mutual funds

   c. Required investment amount for investing in mutual funds

   All investors, both individual and non-individual, have to be KYC (Know Your Customer) compliant. The KYC process involves establishing a) identity and b) address of the investor as this is mandated under the Anti-money Laundering Laws. For application for investment in mutual funds, the investor is expected to have completed the KYC process and must have an acknowledgement for having completed the KYC process issued by the KYC Registration Agency (KRA).
   The mutual fund would need the completed application form with the KYC documentation and the requisite investment amount, to allot an investment folio (account number) in the name of the investor.

3. **Where are the application forms of mutual funds available?**
   Application forms of mutual funds are available with offices of mutual funds, distributors and Investor Service Centres. The forms can also be downloaded from the websites of the mutual funds.

4. **What documents are required for KYC process?**
   Permanent Account Number (PAN) Card with photograph as a proof of identity is mandatory for all applicants except those who are specifically exempt from obtaining PAN. For proof of address, passport, Voter's Id, Ration card, Driving License, bank account statement, utility bill etc. serve the purpose. These documents need to be submitted to the distributor or stock broker or depository participant who is buying the mutual fund for the investor.

5. **Are the bank account details required for mutual funds?**
   Investors have to provide the bank details of the sole/first holder of the folio in the application form. This includes the name of the bank where the account is held, the branch and the city, the account number, type of account (current, savings, NRO, NRE, FCNR and others), MICR code and IFSC code. These bank account details are required for crediting dividends and redemption proceeds into the bank account. However, applicants can also choose to receive payments through a demand draft.

6. **How do I track my multiple investments in mutual funds?**
   The investor can track his/her multiple investments in different mutual fund schemes through a Consolidated Account Statement (CAS). This statement provides a consolidated view of all the investments of an investor in securities held in demat form with the Depositories as well as in Statement of Account (SOA) form with Mutual Funds (MF) houses.

7. **What Is NSDL Consolidated Account Statement (CAS)?**
   NSDL CAS is a single account statement consisting of transactions and holdings in investor's demat account(s) held with NSDL and CDSL as well as in units of Mutual Funds held in Statement of Account (SOA) form. The statement enables investors to have a consolidated view of his/her financial assets and provide an insight of his/her portfolio across various asset classes. NSDL CAS provides enrich investor experience of managing his/her portfolio effectively and benefit him/her in many other ways viz. better decision making, simplified monitoring, rich analysis of portfolio etc.
   NSDL CAS enriches experience of investor in managing his/her portfolio effectively and benefited him/her in many other ways viz. better decision making, simplified monitoring, rich analysis of portfolio etc. Some of the value adds of NSDL CAS are as under:

   ✓ Summary of portfolio investments across entire holdings in demat as well as Statement of Account (SOA) form

   ✓ Asset-wise classification of portfolio

   ✓ Graphical representation

   ✓ View of demographic details across demat account(s) and MF folio(s)

   Investors can open a NSDL demat account with any of NSDL Depository Participants (DPs) to avail this facility. Investors can contact the toll free helpline 1800 222 990 for any queries regarding NSDL CAS.

Investor Education initiatives undertaken by NSDL

➢ **Investor Awareness Programmes:**

In order to reach out to investors that are spread across the country and to apprise them about the facilities available in NSDL depository system and the awareness on stock markets, NSDL conducts various Investor Awareness Programmes jointly with it's Depository Participants (DPs) & with Institutions like SEBI, NSE etc. NSDL also conducts various training programmes for its Depository Participants (DPs) on Depository related services. During December 2016, NSDL conducted 30 Investor Awareness Programmes with Participants, College Institutions, SEBI, NSE etc. These programmes were attended by more than 4,100 investors, details as mentioned below:

Sr. No.	Particulars	
1	**Joint Awareness Programmes with DPs**	**No. of Programmes**
	BMA Wealth Creators Limited	4
	ICICI Securities Limited	2
	Jhaveri Securities Limited	2
	Arihant Capital Markets Limited	1
	Globe Capital Market Limited	1
	Karvy Stock Broking Limited	1
	Swastika Investmart Limited	1
	Total Programmes	**12**

2	**Investor Depository Meets (IDMs)**	**No. of Programmes**
	IDMs organized by NSDL	6
	Total Programmes	**6**

3	**Joint Awareness Programmes with other Institutions**	**No. of Programmes**
	Geojit BNP Paribas Financial Services Limited, Eenadu newspaper and NSE	4
	Arth sanket newspaper	1
	Securities and Exchange Board of India (SEBI)	1
	Total Programmes	**6**

4	**Participation at Events**	**No. of Programmes**
	The Indian Institute of Technology Bombay	1
	The SIA College of Higher Education	1
	Ramnarain Ruia College, Mumbai	1
	Emerging Markets Finance organized by The Indira Gandhi Institute of Development Research (IGIDR)	1
	Fintech Summit organized by Indian Chamber of Commerce (ICC)	1
	Investor Fair in association with NSE	1
	Total Programmes	**6**

Read and Win!

In Mutual Funds, what is the difference between an Open-ended Funds & Close-ended Funds?

Send your replies providing your contact details (Name, address and contact no.) with the subject 'Knowledge Wins Contest - January 2017' to info@nsdl.co.in

KNOWLEDGE WINS Contest

Lucky 25 Winners will Win Free Goodies

Terms and Conditions

- NSDL shall be solely responsible for the execution and administration of this Contest.
- This Contest is only open to Indian Citizens. (NSDL employees are not allowed to participate in this contest.)
- All personal details submitted must be accurate and complete and are subject to proof upon request by NSDL.
- NSDL reserves the right, at any time, to verify the validity of entries and entrants and to disqualify any entry not submitted in accordance with these Terms or which tampers with the entry process.
- NSDL reserves the right to discontinue the contest at any given point of time without prior intimation.
- All prize drawings will made on a strictly random basis and the decision made by NSDL will be final

Your suggestions for newsletter are valuable to us. Send in your suggestions mentioning your contact details (contact name, address & contact number) with the subject "Suggestions for the newsletter" to info@nsdl.co.in

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